Tariffs, Tweets, and Tribes

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Given the ongoing trade war, many are wondering if the farm states will support President Trump in the upcoming election. While not a political analyst, I grew up in the farm belt and actually spent a large part of this summer there listening to the banter in small town coffee shops, on long pick-up truck rides to ball games, and handing tools to my old farmer buddies while working on keeping their tractors running. Not that this qualifies me to be able to answer the question of presidential support, but I can at least lay out some of the issues that could impact that decision.

Siding with your Tribe

Voter association with their party in the U.S. seems to be stronger than ever. This is true in the farm states as well, where Republicans mostly dominate. In some states that dominance is by a quite significant margin. For instance, in Kansas the ratio is almost 2-to-1 and in Nebraska Republicans outnumber Democrats 1.5-to-1. Iowa at 1-to-1 is an exception, noting that they have a high percentage of Independents. There are two states with large agricultural underpinnings, however, where the electorate is dominated by large urban populations. Those would be Minnesota and Illinois, where Democrats outnumber Republicans. Since nationally about 38% of voters identify as Independents, the result in many states is determined by their vote. But the only farm state with that high of a proportion of independents is Iowa. The average farm state is closer to a 22% independent representation. So it is much more likely in this case that the dominant party will carry the state. Anecdotally, when I helped my visually impaired parent complete their absentee ballot for the midterm election they told me to just skip the names and vote for the republican.

Given this dominance it is no surprise that Nebraska, Kansas, and the two Dakotas voted for the Republican candidate in all of the last ten presidential elections, while Indiana did so in nine of ten and Missouri in eight of ten. Iowa and Ohio are more evenly split. While all of these states have voted for a democratic presidential candidate at one time, during the last 40 years the republican party has been able to depend on most of the farm states for their electoral votes. It would probably take extraordinary circumstances to break that hold. The question now is: “does the current situation fit the bill?”

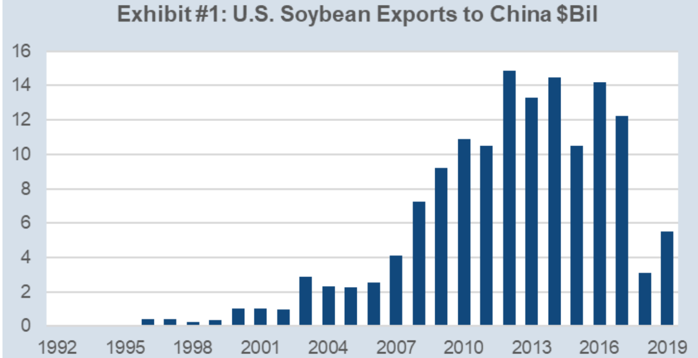
Smoot-Hawley smote Hoover

Two instances where all of these farm states voted democrat were in 1932 and 1936. During his first term, Herbert Hoover and a republican congress passed the Smoot-Hawley Tariff Act of 1930. Retaliation crushed agricultural exports at a time when farmers were already struggling. Franklin Roosevelt soundly trounced Hoover in 1932 taking 472 electoral votes over 59. It is not hard to imagine the farm voter feeling a bit aggrieved by a deliberate trade war on top of the Great Depression and the Dust Bowl days that reduced more than 100 million acres of arable land to a virtual desert in 1932. Certainly the plight of the contemporary farmer is not this dire but some of the talk in the farm belt is starting to draw some parallels to Smoot-Hawley and the Russian Wheat embargo instituted by Jimmy Carter, another one term president.

Poor Customer Relations

Soybean exports to China have never been such a hot topic from main street to wall street to capitol hill. Many believe if the Chinese agree to rollback the tariffs they have applied to ag products, everything goes back to normal. Soybean prices will go back up, and farmers will be happy. If only it were that simple. The U.S. farm community has spent the last 20 years building the Chinese soybean export market from nonexistent in the 1990s to an almost $15 billion customer (see Exhibit #1). That customer only bought $3 billion in 2018. Even with the sizable purchase in August purchases this year are only about $5.5 billion, or about 40% of the 2012-16 average. Instead, China developed new trade relationships with Brazil and Argentina to fill the gap. Those new relationships will be maintained even after the trade war because the U.S. is now considered a less dependable provider. So the trade war has a residual effect for soybean producers, which have historically exported 60% of their production, with about 25% of production going to China alone.

Exhibit #1: U.S. Soybean Exports to China $Bil



Source: US Dept of Commerce, Trade, Aug est. from news

The other residual effect involves all that production that would normally have been exported to China. It went into storage. At the same time as

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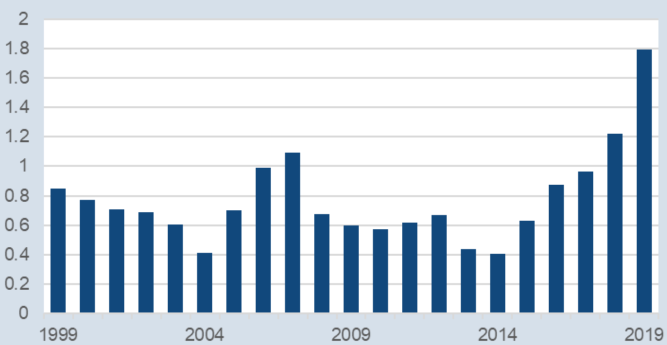
soybean producers lost their biggest client, they had the four biggest crop years on record (see Exhibit #2). The result is an oversupply bubble of almost 2 billion bushels or about half of a normal year of production. The planting troubles this spring will likely reduce production some so a Chinese return to the market will help a bit. But this excess will need to work down over time and prices will not normalize until the surplus is reduced. At current prices the USDA estimates that operating income for a soybean farm is profitable, but once rent, taxes, and equipment replacement are added each bushel results in a loss.

Exhibit #2: Billion Bushels Soybeans in Storage



Source: USDA Survey as of June each year

Softening the Blow

In response, the current administration has implemented the "Market Facilitation Program (MFP), which provides assistance to farmers and ranchers with commodities directly impacted by unjustified foreign retaliatory tariffs." The biggest recipients are soybean producers with a quarter of the 2018 payments going to Illinois and Iowa (see Exhibit #3). Of the top ten states, two are firmly democratic with little hope of swinging toward the present White House occupant in 2020. MFP payments in the current year are being made in three tranches with only the first one guaranteed. The rest depend on progress with trade talks. These payments may soften the blow of lower prices, but most farmers will tell you they prefer to compete on the open market instead of being dependent on the government. On the other hand, the fact that the payments are being made makes farmers feel like there is some empathy for their situation. They might also keep some farmers afloat that otherwise might struggle to make the mortgage payment.

Exhibit #3	% of Total Soybean Production	$Billion MFP Payments	Trump Support 2016
Illinois	15.1%	$1.11	No
Iowa	12.7%	$0.98	Yes
Minnesota	8.3%	$0.68	No
Indiana	7.8%	$0.57	Yes
Nebraska	7.3%	$0.57	Yes
S. Dakota	6.1%	$0.43	Yes
Ohio	6.0%	$0.47	Yes
Missouri	5.6%	$0.44	Yes

The Other Side of the Coin

Receiving less attention is the plight of row crop farmers' other cash crop - corn. Nine of the top soybean states are also top ten corn producers. Which is logical given that farmers prefer to alternate fields between corn and soybeans from year to year to improve the soil structure. Like soybeans, corn in storage has ballooned, creating a supply overhang which weighs on prices. This dynamic is similar to that experienced during the three highest production years on record (2016, 2017, 2018). During this period, bloated supplies carried over from year-to-year, exacerbated by falling demand from the largest customer due to a political position of the current administration. In the U.S., 40% of corn production goes to create ethanol with the distillate then fed to cattle. The U.S. mandate for refiners to add ethanol to gasoline has driven up ethanol demand, with production increasing ten-fold from 2000 to 2018. The current administration, however, is more oil friendly and less environmentally conscious than prior ones, so they have become much more active in granting waivers to refiners for exclusion from the ethanol requirement. As a result, ethanol production growth has gone in reverse. Once again a large supply overhang coupled with a tailing off of demand has been an anchor on crop prices. The income statement of corn production is similar to soybeans. Positive operating income can turn negative when adding in high land rents, equipment replacement, and taxes.

Good Times beget Bad

But farmers are also aware that their profit issues are not all government related. Demand for soybeans from China and for corn from ethanol producers drove prices higher for row crop output in the early 2000s. Commodity prices topped out in 2012 with corn averaging $6.80/bushel, 83% higher than today's price of $3.70, and soybeans $14.15/bushel, 60% higher than today's price of $8.80. Input costs, equipment, rents, and land prices followed crop prices upward. The USDA estimated operating costs rose 53% for corn production nationally and 43% for soybean production in the five years to 2012. Since 2012 they have only fallen -4% and -6%, respectively. It does not take a financial genius to know that when your sales prices drop 60% to 83%, but your cost of production only goes down -4% to -6% a massive margin squeeze is the result. Land rents and equipment prices have also remained inflated by good times with dealers and landlords loathe to give up price increases gained during the good times. So in the farmers' eyes the president is

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only one of their demons. He may even be one of the lesser ones when compared to John Deere, the farm manager who is trying to extract the maximum rent possible from them, and the wealthy urban investor buying up farmland hoping to turn a profit.

Déjà vu

Rising debt loads and delinquencies, coupled with bankruptcy filings in the last twelve months at almost double the ten year average rate have brought back memories of the 1980s for the older farm generation. You can even draw some parallels with the causes. Good times in the 1970s led to rising grain and land prices, which prompted lax lending standards. High production levels and the Russian grain embargo reversed the upward trend of grain prices and land values, similar to the bumper crops in recent years coupled with Chinese tariffs. But also contributing to the 1980s crisis were high interest rates, rising oil prices, and a strong dollar. Farm debt compared to assets climbed to 22% with the average prime rate ranging from 16% to 10% between 1980 and 1985. While the debt-to -asset ratio has risen from 11% to 13% since 2012 it is still considerably lower than the 1980s levels. Coffee shop talk in the farm belt turns to bankruptcies on occasion with the defining statement "Trump is going to bankrupt some farmers". But it probably will not be widespread enough to lead to a mass exodus from the Republican party.

Bad could be Good

You may recall the pictures of rivers bursting their banks and roadways being washed out in the Midwest in the spring. Those unrelenting rains meant that many of those fields were planted late or not at all. The logical assumption is that production come harvest time will be lower and the excess supply overhang may be eased a bit. So far, the USDA is still projecting a pretty healthy crop to be harvested, which is keeping a lid on prices. That view has added the agency to the long list of demons for farmers to project their ire. To quote my brother, "we are one crop failure away from $7/bushel corn and $14/bushel beans". That was a couple of years ago before the overhang of grain got so big. But assuming production falls short of projections crop prices should rise some ,improving the profit from the fields that are harvested. Yes, lower overall production increases profits because commodity prices tend to rise further than yields fall and vice versa. If that is the case the farming community will feel much better about life in general and could be much more forgiving of trade issues.

Where's the Beef?

In some of these states, annual receipts for beef sales exceed either corn or soybeans, so a relevant question is: "where do these states stand in the political mix?". Ranchers presently have a very good relationship with the current administration. Some would say the best since Ronald Reagan. They have their own economic struggles that are unrelated to politics. Yet there are still some political implications to consider. If USMCA is not ratified there is a risk that Mexico and Canada could use beef tariffs to retaliate. On the positive side is the just announced trade deal with Japan where the proposed beef tariff reduction would put U.S. beef on an equal footing with signatories to the CPTPP agreement, the replacement to the TPP that President Trump withdrew from on his first day in office. Japan is already our largest beef export market, but we are not their largest supplier so this could be significant and a feather in the cap of the current administration.

By the Numbers

Despite their general unhappiness with the situation, surveys continue to show farmers support for the president. Many believe a final trade agreement will benefit them. A survey of producers by Purdue University in August shows less optimism than the previous month, but still about average for the last few years. About 72% of those polled think the trade dispute will be settled in a way that benefits agriculture, but 58% still expect to receive MFP payments in 2020. MFP payments are the government subsidies given to offset the impact of tariffs. That would imply more than half of producers think the trade war will spill over into next year. Another data point comes from The Farm Journal, which publishes an approval poll. While the numbers have deteriorated some this year, 71% approve of the way Donald Trump is handling his job in this poll. The Morning Consult, a political polling service, publishes survey results by state. Similarly, they show deterioration but approval responses still outpace disapproval responses in the majority of farm states. In Indiana and Nebraska the gap is 2% (% approve minus % disapprove), in Kansas it widens to 4%, while South and North Dakota are 5% and 8% respectively. The gap is negative in Illinois, Minnesota, Iowa, and Ohio. So while the talk in the farm states might lean negative, but from a polling standpoint the approval rating is still pretty positive.

Generational Farms

At least in Nebraska, real estate taxes are a significant portion of state funding and the largest target is farmland. So farmers are quite sensitive toward politicians that want to tax their land. Both Elizabeth Warren and Bernie Sanders have suggested estate tax rates similar to the George W. Bush era, which started at 55% with a $675,000 exclusion when he took office and ended at 45% with a $3.5 million exclusion (versus the current 40% rate with a $11.4 million exclusion). Raising crops requires land, either owned or rented. Most family farms have accumulated land over generations and the value of that land has appreciated mightily. In Nebraska, the typical farm is 950 acres of center pivot irrigated land with a value of about $6,000 per acre, or $5.7 million for the whole farm. That would result in a large estate tax bill. Typically any extra accumulated cash has gone back to buy more land. So two of the Democratic front

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runners have proposals that would potentially result in part of an inherited farm having to be sold off to pay the estate taxes at a death. This issue haunts even those that it might not impact and is likely to be used by the Republican party in the election. If either of these two are the Democratic nominee it will be very difficult for them to get the farm vote. Joe Biden's moderate policies are more palatable for the more moderate Republican base. But for those stanch right leaners his linkage to President Obama is a strike against him. The way the farm vote swings may depend on who the challenger is.

The Urbanization of Farm States

Keep in mind that even farm states have cities, and few of those states are dominated by a rural population. Illinois and Minnesota have large dominant Democratic leaning urban populations. In Nebraska, 54% of the population lives in metropolitan areas with a population over 50,000, the definition that the Census Bureau uses to define it as urban. Kansas and Ohio are split roughly 50/50, while Indiana and North Dakota are more than 40% urban. It is safe to say that the political view of a school teacher in Omaha, population 663,000, is not totally aligned with a farmer in Minden, NE, population 3,000. But the way these states have voted in the past implies some alignment. Yet, does it hinge on the health of the farm economy? Much of the urban population migrated from rural areas. So some city dwellers have brothers, sisters, etc. back home that will influence them. But I also remember plenty of university friends from Omaha having never been on a farm with little empathy for agriculture issues.

Jobs Drive Votes

Political analysts like to link voter satisfaction with the incumbent to the employment picture. One University of Nebraska study linked 25% of the state's labor income to agriculture. A similar study in Iowa linked 17% of its workforce directly to agriculture or related industries. So what happens in agriculture does matter. But so far the jobs picture is still pretty positive (see Exhibit #4) with unemployment well below the national average and nonfarm jobs still expanding, while crop production jobs are a mixed bag. Conventional wisdom would suggest that unless the job situation deteriorates in those states that currently support President Trump that they will continue to do so.

Exhibit #4	August '19 Unemployment Rate %	Change* in Crop Prod Employment	YOY Change in Non-Crop Prod Employment
U.S.	3.7%		
N. Dakota	2.4%	0.7%	0.2%
Iowa	2.5%	2.5%	0.6%
S. Dakota	2.9%	-1.6%	2.1%
Nebraska	3.1%	-0.5%	0.5%
Kansas	3.2%	-2.8%	1.0%
Indiana	3.3%	2.4%	0.7%

**year-over-year change in Q1 '19* *Source: Strategas Research Partners, BLS*

It's Complicated

Hopefully, you will forgive the wandering nature of the above. The question posed, "will the farm states support President Trump in the upcoming election?", seems like the answer should be easy. In the end, the farm vote may end up being on a single issue. But as you can see, there are multiple moving parts to the political climate in farm states. Most of the data supports a farm vote in the president's favor at this point. For a democrat to win some of these states they would have to demonstrate some alignment with farm issues. Maybe addressing the cost of health care might do the trick since farmers are not covered by any group health plans. But it is a long way to November 2020, and potential issues abound. Where farm state support will land is way too early to decide.